Perris Station Apartments
Perris, California

Deals for Years to Come

California Firm Begins Stream of Transactions from Large Portfolio of Acquired GP Interests

For California developer/owner Michael Costa, a lengthy pipeline of future affordable housing disposition and preservation transactions is just getting started.

"It's a very nice place to be in," says Costa, president, CEO, and managing member of Highridge Costa Investors, LLC (HCI) and Highridge Costa Housing Partners, LLC (HCHP), based in Gardena, Calif. "We're looking forward to a pretty big year in 2014. I literally have about 14 to 15 opportunities – acquisition/rehab – coming out of our own portfolio that are ready this year. So we're going to be busy."

Recent and future transactions stem from a portfolio of general partner interests in 276 low-income housing tax credit (LIHTC) properties in 34 states and Puerto Rico that are held by HCI. Costa, along with Highridge Partners LLC, purchased the company and its portfolio from Citibank in November 2011. Approximately 130 of the 276 properties are in California; the rest outside the state. About half the properties were originally developed by predecessor companies headed by Costa.

Michael Costa

Costa says he spent 2012 getting all the properties on a sound financial footing to prepare them for future transactions. "That year allowed us to clean up from the aftermath of the 2008-2010," he says. "So we did a lot of work on our asset management, focusing on the cash flow and expenses of each property."

In 2013, HCI, working through the Tax Credit Group of Marcus & Millichap, solicited bids on an initial portfolio of 33 of the properties – all outside California and in Years 11-15 of their initial tax credit compliance period.

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After reviewing offers from 20 companies, HCI narrowed the list to a handful of firms and eventually selected Peak Capital Partners, an owner and manager of affordable, market-rate, and student apartment properties based in Provo, Utah. According to Costa, fee simple sales of 17 of these 33 properties closed in 2013. With one exception, the rest will close before June 2014.Prior to each sale, HCI was the general partner in the lower-tier project partnership as well as the general partner in the limited partner entity investing in the project.

As the California properties reach Year 15, HCI generally plans to either sell them fee simple or facilitate a new acquisition/rehab transaction through HCHP using new housing tax credits.

HCI plans to sell all of the remaining properties outside California as they reach Year 15. "We have about four or five more coming into the fold that we will start working on this year," says Costa.

Plans for California Properties

As the California properties reach Year 15, HCI generally plans to either sell them fee simple or facilitate a new acquisition/rehab transaction through HCHP using new housing tax credits, according to Costa. In the latter case, a local nonprofit will serve as the sole general partner of the new lower-tier partnership, in order to qualify the property for tax exemption, while HCHP will serve as the general partner in the limited partner investing in the project. An affiliate of HCHP will syndicate the new tax credits.

Six or seven California properties reached Year 15 in 2013 and acquisition/rehab transactions have closed for three of them. "We're right in the middle of rehab on all three properties, spending about $10,000 per unit," says Costa. In each, HCHP formed a joint venture with the original nonprofit that developed the property. The nonprofit has stayed on as the sole general partner in each new project partnership.

The three properties are: Tyler Park Townhomes, 88 units, in Greenfield; Harden Ranch Apartments, 100

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units, in Salinas; and Westside Village Apartments, 100 units, in Shafter.

The bulk of the financing for the acquisition and rehab costs came from equity generated by 4% housing tax credits and proceeds of long-term fixed-rate tax-exempt bonds privately placed with a single investor. The bonds achieved a triple-A rating from being placed in a Freddie Mac Tax-Exempt Bond Securitization pool.

Costa says his firm is structuring new acquisition/rehab transactions for the remaining three or four California properties that reached Year 15 in 2013.

In 2014, 10 California properties will reach Year 15. Costa anticipated that about half will be preserved as affordable housing through new acquisition/rehab transactions funded by 4% tax credit equity and tax-exempt private activity bonds. He expected the rest will be sold to nonprofit housing sponsors in a unique transaction structure not using new tax credits. This will involve the issuance of tax-exempt Section 501(c)(3) bonds in three series to pay for acquisition and renovation costs. These obligations, either senior or subordinate bonds, will mostly be long-term fixed-rate bonds. However, a portion will be "lower floater" bonds on which the interest rate will adjust every seven days, subject to a rate cap.

Special Situations

Costa said while the goal is to dispose of all of the California properties for new acquisition/preservation transactions involving HCHP as they reach Year 15, not all will be conducive to this approach. The reason, he said, is that in some parts of California, current annual rent limits for new LIHTC projects are substantially below existing rent levels for HCI's tax credit properties, due to a substantial drop in HUD's annual area median income since the time that the properties were originally developed. In these situations, said Costa, HCI may either sell the property to a nonprofit using the Section 501(c)(3) bond structure or else continue holding the property until HUD's area median income rebounds.

In some cases, HCI can issue a seller note to make a new preservation transaction work.

Costa said the youngest property in HCI's portfolio is two months old, noting HCHP develops new LIHTC projects as well. TCA